W.Y. CHIN

v.

SARAHON CONSTRUCTION SDN. BHD. & ANOR.

HIGH COURT MALAYA, KUALA LUMPUR
DATO' ABU MANSOR BIN ALI J.
[ORIGINATING SUMMONS NO.
R1-24-95 OF 1991]
6 AUGUST 1992

ARBITRATION: Multi-party arbitration - Jurisdiction - Third party claim included in the claim of the proper party - Whether third party a stranger - Whether arbitrator had jurisdiction to hear and make declaratory order in respect of third party claim.

This was an application by the arbitrator, by way of case stated under s. 22 of the Arbitration Act 1952, referring to the High Court for determination two questions of law which had arisen in the course of arbitrating a dispute between Standard Chartered Bank (the bank) and Sarahon Construction Sdn Bhd (the main contractor), the respondents herein.

The case before the arbitrator was that the bank had terminated a certain construction contract which they had entered into with the main contractor. By then, however, the main contractor had already sub-contracted the relevant contract works to two contractors (the sub-contractor), with the result that, because of the said termination, the main contractor was forced to terminate its contract with the sub-contractor. This resulted in the sub-contractor filing a claim amounting to RM 1.8 million against the main contractor. The main contractor, on its part, sued and claimed from the bank damages for wrongful termination of contract, including the RM 1.8 million damages sought against it by the sub-contractor. The bank took a preliminary objection and submitted *inter alia* that the arbitrator had no jurisdiction to hear the claim as the sub-contractor were third parties and strangers to the dispute.

Before the High Court the issues were (i) whether the arbitrator had the jurisdiction to hear and make a declatory order in a third party claim and (ii) whether it would be irregular, improper or procedurally incorrect for the arbitrator to hear the third party claim.

Held:

[1] The gist of private arbitrations derives from the fact that the parties have agreed to submit to arbitration particular disputes arising between and only between them. It is implicit in this that strangers shall be excluded from the hearing and conduct of the arbitration and that neither the tribunal nor any of the parties can insist that the dispute shall be heard or determined concurrently with or even in consonence with another dispute , however convenient that course may be to the party seeking it and however closely associated the disputes in question may be.

[2] The arbitrator, in arbitrating the dispute herein, will inevitably examine the sub-contractor's claim which *ab initio* must depend on whether or not there was an arbitration agreement between the sub-contractor and the bank in order to clothe the arbitrator with the necessary jurisdiction. The sub-contractor clearly had none. The arbitrator therefore only has jurisdiction to entertain the claim of the main contractor and not that of the sub-contractor, they being strangers to the contract. In the circumstances the Court can only answer the first question in the negative and the second question in the affirmative.

[Preliminary objection upheld].

Cases referred to:

D & C Finance Bhd. v. Overseas Assurance Corpn. Ltd. [1989] 2 CLJ 598 / [1989] 3 MLJ 240 ***(refd)***
Oxford Shipping Co. Ltd. v. Nippon Yusen Kaisha [1984] 3 All ER 835 ***(foll)***

Saint Line Limited v. Richardsons, Westgarth & Co., Ltd. [1940] 2 KB 99 ***(dist)***
Davies v. Collins [1945] CA 247 ***(dist)***
Heyman & Anor. v. Darwins, Limited [1942] AC 379 ***(dist)***

Legislation referred to:
Arbitration Act 1952, s. 22
Contracts Act, s. 74

Other sources referred to:
Commercial Arbitration, Mustill & Boyd, 2nd Edn., p. 390
Construction Law, John Uff, 5th Edn., p. 6
Construction Law in Singapore and Malaysia, Nigel M. Robinson and Lavers, p. 199

For the 1st defendant / respondent - M. David Morais; M/s. Sri Ram & Co.
For the 2nd defendant / applicant - Chang Wei Mun; M/s. Mah & Din

JUDGMENT

Abu Mansor bin Ali J:
In the 2nd defendant's originating summons dated 5 December 1991 enclosure (3) the defendants applied for orders that on the hearing of an application by W.Y.Chin, the arbitrator, in the above-mentioned arbitration, by way of case stated under s. 22 of the Arbitration Act 1952 (Revised 1972), this Court does give its decision in respect of the questions of law described in the special case annexed hereto, that has arisen in the course of the said arbitration, and that the costs of and occasioned by this application be costs in the arbitration.

In this application before me Encik David Morais with Cik P.K. Dhillon appeared for the 1st defendant/respondent and En. Chang appeared for 2nd defendant/applicant.

The background to this dispute is as follows. In this case, in the arbitration below, the plaintiff is an architect, the 1st defendant, main contractor, is the claimant (claimant) and the 2nd defendant, bank, the employer, is the respondent (respondent). The arbitration (arbitration) was instituted pursuant to a construction contract (exhibit 1) (contract).

In the arbitration, the claimant alleged that the respondent has wrongfully terminated the contract as a result of which it has suffered damages.

As a result of the said wrongful termination, the claimant says, it had in turn to terminate its contract with the nominated sub-contractor Dynamic Drilling (nominated sub-contractor) and the nominated sub-contractor has made a claim against the claimant. The claimant is seeking a declaration that in the event it is liable to the nominated sub-contractor, the claimant is entitled to be indemnified by the respondent.

The damages claimed has been expounded in exhibit 2 page 28 and pages 115 and 116 (damages) and include the actual amounts payable to the nominated sub-contractor and also amounts payable to the principal sub-contractor (principal sub-contractor) arising out of the respondent's alleged wrongful termination. The claimant sub-contracted to two contractors.

In the arbitration, therefore, the claimant has two type of claims one is damages alleged to be suffered by the claimant. There is no dispute as to the arbitrator's jurisdiction to try this claim. But then the claimant, apart from his claim, also put in a claim for damages by way of third party claim for the sub-contractors.

The sub-contractors are claiming sums in excess of 1.8 million from the claimant and the claimant now seeks to include this claim in the arbitration.

At the start of arbitration two issues of law were raised, in the form of preliminary objection, by the respondent. They were:

(i) Whether the arbitrator has the jurisdiction to hear and make a declaratory order in a 3rd party claim, so to speak, by a sub-contractor;

(ii) Whether it would be irregular, improper or procedurally incorrect for the arbitrator to hear 3rd party claim, so to speak.

Hence this special case stated for the determination of the above two issues to this Court pursuant to s. 22 of the Arbitration Act. When this matter came up for hearing, on the application of the respondent, they obtained an order for a stay of the arbitration proceeding pending the determination of these two issues.

It is submitted by applicant's Counsel that the answer to the first two above issues is in the negative and the second one in the affirmative. Firstly, on the issue of declaration, applicant before me, submitted that the arbitration clause i.e. Clause 34 in the contract is sufficiently wide enough to confer jurisdiction. Clause 34 provides:

34. (1) In the event that any dispute or difference should arise between the Employer or Architect on his behalf and the Contractor, either during the progress or after the completion or abandonment of the works, as to any matter or thing of whatsoever nature arising thereunder or in connection therewith (including any matter or thing left by this contract to the discretion of the Architect or the withholding by the Architect of any certificate to which the Contractor may claim to be entitled or the measurement and valuation mentioned in Clause 30(5)(a) of these Conditions or the rights and liabilities of the parties under Clauses 25, 26, 31 or 32 of these Conditions), then such disputes or differences shall be referred to arbitration.

Upon the disputes or differences having arisen any party may serve written notice on the other party that such disputes or differences shall be referred to an arbitrator to be agreed between the parties or failing agreement or absence of reply or reluctance to act by the other party then the party may, after the expiry of fourteen days from the date of the notice to concur on the appointment of an arbitrator, apply to the President or Vice President for the time being of Pertubuhan Akitek Malaysia to appoint an arbitrator and such arbitrator so appointed shall by virtue of this agreement be deemed to be appointed with the agreement and consent of the parties to the contract.

Upon appointment the arbitrator shall with despatch initiate the arbitration proceedings following the provisions of the Arbitration Act 1952 (Revised 1972). The hearing may be "ex parte" should either party, having been given due notice, fail to attend.

(2) ...
(3) ...
(4) The award of such arbitrator shall be final and binding on the parties.

In support of that proposition the applicant cited Mustill & Boyd on **Commercial Arbitration**, 2nd Edn., p. 390:

4. Declaratory relief

An arbitrator has power to make an award declaring what the rights of the parties are, and in some cases the arbitrator's power may be limited by the terms of the submission to making such an award. Thus, if an arbitrator is appointed to decide 'whether the buyer was entitled to reject the goods', he may award 'that the buyer was not entitled to reject the goods' but cannot go on to award damages for wrongful rejection.

The power to make a declaratory award is of great value where a dispute has arisen about the meaning of a contract or a lease which still has some time to run, and where the dispute can be expected to recur in the future. But the arbitrator should beware of being lured into deciding hypothetical questions on an assumed basis of fact, remembering that he only has jurisdiction to decide *bona fide* disputes and that his award may simply give rise to further disagreement if the assumed facts later turn out to be wrong.

In *D & C Finance Bhd. v. Overseas Assurance Corpn. Ltd.* [1989] 3 MLJ 240 and at 243 His Lordship Dr. Zakaria Yatim J quoted Rowlatt J. in *London & North Western Railway v. Jones* at page 38 where he said:

... if there is a difference of any kind arising under the section before action, that matter must be decided by arbitration and the Courts have no jurisdiction to determine that difference ...

Learned Counsel for the applicant submitted further that the arbitrator derives his jurisdiction from the contract between the employer (the bank) and the main contractor. By this the

arbitrator has only jurisdiction to entertain the claim of the main contractor against his employer as the sub-contractors are strangers to the contract.

In the textbook "**Construction Law**" by John Uff, 5th Edn., at p. 6 the author mentions one of the difficulties of construction industry arbitration is that, dispute tend to involve more than two parties. Multi-party arbitration is subject to certain theoretical difficulties, but the main ones are practical ones. You cannot force a party into a multi-party arbitration unless he agrees to it. The gist of these learned writing if the main contractor wants to seek an indemnity when served by the 2nd defendant (employer) in respect of 3rd party claims made by the sub-contractors or if the sub-contractors tried to be joined they will certainly fail as they are strangers to the action. The applicant further cited *Oxford Shipping Co. Ltd. v. Nippon Yusen Kaisha* [1984] 3 All ER 835 where at page 842 Leggatt J held:

> The concept of private arbitrations derives simply from the fact that the parties have agreed to submit to arbitration particular disputes **arising between them and only between them.** It is implicit in this that strangers shall be excluded from the hearing and conduct of the arbitration and that neither the tribunal nor any of the parties can insist that the dispute shall be heard or determined concurrently with or even in consonance with another dispute, however convenient that course may be to the party seeking it and however closely associated the disputes in question may be. The only powers which an arbitrator enjoys relate to the reference in which he has been appointed. They cannot be extended merely because a similar dispute exists which is capable of being and is referred separately to arbitration under a different agreement.

In the **Construction Law in Singapore and Malaysia** by Nigel M. Robinson and Lavers at page 199 the learned authors echo the same principle applicable in Malaysia and said that strangers must be excluded - they cannot attend or give evidence.

Counsel also submitted that the main contractor had himself to blame for not choosing the many varied standard agreement clauses available which cover claims by the sub-contractors but the parties chose instead an old PAM 69 containing only 34 clauses when there were other specimen agreements or a modified clause 34.

Mr. Morais for the respondent contended that the arbitrator has jurisdiction to declare that the claimant is entitled to be indemnified by the respondent against his liability to the nominated sub-contractors and other contractors.

The main contractor's claim is for damages (as in pages 115-117 of enclosure (1)). After the damages had been obtained then come declaration. No distinction is made between claim made by sub-contractor and claim by main contractor. The summary represents the entire damages and the mention of sub-contractors in the summary is only for particularisation of the claim. For example para 2 of page 115 enclosure (1) is the claim for damages suffered by the main contractor or contingent. Para 3 of page 116 is an alternative in the event that the main contractor is likely to suffer.

As regards the arbitration clause at page 19 of enclosure (1), he submitted Clause 34 makes reference to Clause 26 and the clause deals with the rights and remedies available to the main contractor in the event that his contract is determined. Counsel submitted that reading Clause 34 together with Clause 26(2)(b)(iv) and (vi) the arbitrator is conferred with sufficient jurisdiction to hear claim brought by his client against the employer.

Counsel for the respondent submitted further that the arbitrator can award damages to the main contractor. He submitted that the main contractor's claim must naturally flow from wrongful termination of ordinary contract and ordinary contract principle i.e. Section 74 of the Contracts Act will apply. Section 74:

> **Compensation for loss or damage caused by breach of contract.**
>
> (1) When a contract has been broken, the party who suffers by the breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from the breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

(2) Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

Compensation for failure to discharge obligation resembling those created by contract.

(3) When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default as if the person had contracted to discharge it and had broken his contract.

In ordinary contract principles if employer knew or has reason to know that his breach would cause the loss suffered by the main contractor he is liable to compensate the main contractor. Under the second limb of that s. 74 if it is not too remote, compensation can be ordered. He cited *Saint Line Limited v. Richardsons, Westgarth & Co. Limited* [1940] 2 KB 99 at 104 where the learned Atkinson J. dismissed what is 'indirect' or 'consequential':

> In my judgment, the words "indirect or consequential" do not exclude liability for damages which are the direct and natural result of the breaches complained of.

Counsel submitted this case is analogous to their case as they are claiming for their sub-contractors. It is then for the arbitrator to decide whether the claim of the arbitrators is reasonably close or not.

Counsel also referred the Court to the case of *Davies v. Collins* [1945] CA 247 which decided that the main contractor will be liable to the employer for any deficiency of the sub-contractor. Counsel said conversely the main contractor is entitled to hold the employer liable for all damages including claims made by sub-contractors.

Counsel further added that if one lump sum figure is put up in the claim then there is no question of challenge to the jurisdiction before the arbitrator but only the question of remoteness.

Counsel for the respondent submitted that the applicant's Counsel's argument that there is a 3rd party claim is misconceived because it is not a third party situation because the main contractor claimant is not defending nor does he claim indemnity.

As regards applicant's Counsel's contention:

(a) Award if made will not bind sub-contractors respondent says there is no attempt to obtain an award binding on sub-contractors merely seeking to establish damages - not trying to bring sub-contractors;
(b) On the issue of mitigation of damages will not be decided before the arbitrator because the sub-contractors will not be before the Court, Counsel's reply again this is irrelevant because the duty of mitigation damages would fall on the main contractor and he has to face the penalty if he cannot give a satisfactory answer.
(c) On applicant's Counsel's allegation that his client will be prejudiced for non discovery or not being able to call his witnesses, this is again irrelevant as the claim of the main contractor includes that of sub-contractor's it is for the main contractor to call his witnesses lest he will pay the penalty;
(d) Applicant's obtaining a declaration for indemnity should not be allowed.

Respondent's Counsel submitted that the arbitrator is entitled to make an alternative declaratory order even on the issue of indemnity. Counsel cited *Heyman And Anor. v. Darwins, Limited* [1942] AC 379 which decided a dispute fell squarely within an arbitration clause and the arbitrator is entitled to make a declaration.

Counsel submitted that on this authority cited in this instant case the claim by the main contractor including the claim against him is within the arbitrator's jurisdiction to issue a declaratory award and also indemnity. He therefore submits that the Court's answer to para 8.1 should be in the affirmative and para 8.2 should be in the negative.

In the situation and on the facts of this particular case where the main contractor is claiming against the employer and considering that none of the cases cited by Counsel for the respondent

dealt with claims including the claims of 3rd party against the employer I find merit in the argument of Counsel for the claimant and I apply the decision in *Oxford Shipping Co. Ltd. v. Nippon Yusen Kaisha* [1984] 3 All ER 835 as the more reasonable and practical of the construction to put in answering the questions put before me. In whatever way we look at it and whatever terms we employ, sub-contractor or 3rd party, in my view, we cannot escape the modus of proving the main contractor's claim against the employer. It will and must end up in the close examination of the sub-contractor's claim and when that is done, the arbitrator cannot escape having to examine the sub-contractor's claim which *ab initio* must depend on whether or not there was an arbitration agreement between the sub-contractor and the employer as to clothe the arbitrator with jurisdiction. The answer to that is he has none.

I therefore answer the first question in para 8.1 in the negative and answer the second question in para 8.2 in the affirmative because it includes claims of 3rd party with costs to be cost in the cause.